8

Nos. 06-1454, 06-1457, 06-1462 and 06-1468 8-6-07

# In the Supreme Court of the United States

SEMPRA GENERATION, ET AL., PETITIONERS

*v.*

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.

MORGAN STANLEY CAPITAL GROUP INC., PETITIONER

*v.*

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

CALPINE ENERGY SERVICES, L.P., ET AL., PETITIONERS

*v.*

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

DYNEGY POWER MARKETING, INC., ET AL., PETITIONERS

*v.*

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.

*ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

**BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION**

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## QUESTION PRESENTED

Whether, under *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), the Federal Energy Regulatory Commission may take into account the severe market dysfunction of the 2000-2001 western energy crisis in determining the standard to be applied in its review of contracts for the sale of electric power.

## TABLE OF CONTENTS


Page

Opinions below ..... 2
Jurisdiction ..... 2
Statement ..... 2
Argument ..... 11
Conclusion ..... 25


## TABLE OF AUTHORITIES

Cases:


*Boston Edison Co.* v. *FERC*, 233 F.3d 60 (1st Cir. 2000) ..... 24

*California ex rel. Lockyer* v. *FERC*:

99 F.E.R.C. ¶ 61,247, reh'g denied, 100 F.E.R.C. ¶ 61,295 (2002) ..... 4, 5, 6

383 F.3d 1006 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007) ..... 3, 4, 5, 7, 13

*California ex rel. Lockyer* v. *British Columbia Power Exch.*, 100 F.E.R.C. ¶ 61,295 (2002) ..... 5

*California Power Exch. Corp., In re*, 245 F.3d 1110 (9th Cir. 2001) ..... 6

*CAlifornians for Renewable Energy, Inc.* v. *California Pub. Utils. Comm'n*, 119 F.E.R.C. ¶ 61,058 (2007) ..... 12, 15, 16, 22, 23, 24

*Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210 (1989) ..... 4, 5

*Coral Power, L.L.C.* v. *California ex rel. Brown*, 127 S. Ct. 2972 (2007) ..... 7

*Elizabethtown Gas Co.* v. *FERC*, 10 F.3d 866 (D.C. Cir. 1993) ..... 4

Cases—Continued: Page

*FPC* v. *Sierra Pac. Power Co.*, 350 U.S. 348 (1956) ..... 8, 11, 21
*French Broad Elec. Membership Corp.* v. *Carolina Power & Light Co.*, 92 F.E.R.C. ¶ 61,283 (2000) ..... 20
*Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251 (1916) ..... 25
*Maine Pub. Utils. Comm'n* v. *FERC*, 454 F.3d 278 (D.C. Cir. 2006) ..... 23
*Northeast Utils. Serv. Co.* v. *FERC*:
993 F.2d 937 (1st Cir. 1993) ..... 19
55 F.3d 686 (1st Cir. 1995) ..... 19, 21, 23
*Pacific Gas & Elec. Co.*, 81 F.E.R.C. ¶ 61,122 (1997) aff'd, 82 F.E.R.C. ¶ 61,123 (1998) ..... 6
*Pontook Operating Ltd. P'ship* v. *Public Serv. Comm'n*, 94 F.E.R.C. ¶ 61,144 (2001) ..... 20
*Potomac Elec. Power Co.* v. *FERC*, 210 F.3d 403 (D.C. Cir. 2000) ..... 23, 24
*San Diego Gas & Elec. Co.* v. *Sellers of Energy & Ancillary Servs.*:
93 F.E.R.C. ¶ 61,294 (2000) ..... 7
95 F.E.R.C. ¶ 61,418 (2001) ..... 7
*San Diego Gas & Elec. Co.* v. *FERC*, 904 F.2d 727 (D.C. Cir. 1990) ..... 24
*San Diego Gas & Elec. Co.* v. *Public Serv. Comm'n*, 95 F.E.R.C. ¶ 61,073 (2001) ..... 21
*Tejas Power Corp.* v. *FERC*, 908 F.2d 998 (D.C. Cir. 1990) ..... 4

Cases—Continued: Page

*United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) ..... 8, 11
*Verizon Commc'ns, Inc.* v. *FCC*, 535 U.S. 467 (2002) ..... 8

Statutes:

Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594:
§ 1283, 119 Stat. 979 (to be codified at 16 U.S.C. 824v (Supp. V 2005)) ..... 16
§ 1284, 119 Stat. 980 (to be codified at 16 U.S.C. 825o-1 (Supp. V 2005)) ..... 16
Federal Power Act, 16 U.S.C. 791a *et seq.* ..... 2
16 U.S.C. 824(b)(1) ..... 2
16 U.S.C. 824d(a) ..... 2
16 U.S.C. 824d(b) ..... 2
16 U.S.C. 824d(c) ..... 3
16 U.S.C. 825*l*(a)-(b) ..... 25

Miscellaneous:

*AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018, on reh'g, 108 F.E.R.C. ¶ 61,026 (2004) ..... 3, 15
FERC Staff, *Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices* (2003) <www.ferc.gov/legal/maj-ord-reg/land-docs/PART-I-3-26-03. pdf> ..... 11, 17
67 Fed. Reg. 31,044 (2002) ..... 15
70 Fed. Reg. 8253 (2005) ..... 15

Miscellaneous—Continued: Page

71 Fed. Reg. 4244 (2006) ..... 15
72 Fed. Reg. 3958 (2007) ..... 15
*Electric Quarterly Reports*, 105 F.E.R.C. ¶ 61,219 (2003) ..... 15
*Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity & Ancillary Servs. by Pub. Utils.*, 115 F.E.R.C. ¶ 61,210 (2006) ..... 3
*Market Based Rates for Wholesale Sales of Elec. Energy, Capacity, & Ancillary Servs. by Pub. Utils.*, 119 F.E.R.C. ¶ 61,295 (2007) ..... 15
*Notice of Proposed Rulemaking*, 118 F.E.R.C. ¶ 61,031 (2007) ..... 15
*Order Amending Market-Based Rate Tariffs & Authorizations*, 105 F.E.R.C. ¶ 61,218 (2003), order on reh'g, 107 F.E.R.C. ¶ 61,175 (2004), petition for review denied, No. 04-1238, 2007 WL 1791011 (D.C. Cir. June 22, 2007) ..... 15
*Order Revoking Market-Based Rate Auth., Establishing Hearing & Settlement Judge Procedures, & Terminating Sec. 206 Proceeding*, 113 F.E.R.C. ¶ 61,124 (2005) ..... 15
*Prohibition of Energy Mkt. Manipulation*, 114 F.E.R.C. ¶ 61,047 (2006) ..... 15
*Reporting Requirement for Changes in Status for Pub. Utils. with Market-Based Rate Auth.*, 110 F.E.R.C. ¶ 61,097, reh'g granted in part, 111 F.E.R.C. ¶ 61,413 (2005) ..... 15
*Revised Pub. Util. Filing Requirements*, 99 F.E.R.C. ¶ 61,107, order on reh'g, 100 F.E.R.C. ¶ 61,074 order on reh'g, 100 F.E.R.C. ¶ 61,342 (2002) ..... 15

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**BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION**

## OPINIONS BELOW

The opinions of the court of appeals (Pet. App. 1a-15a, 268a-329a) are reported at 474 F.3d 587 and 471 F.3d 1053.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. 91a-214a, 215a-267a; 06-1462 Pet. App. 246a-313a, 314a-363a) are reported at 103 F.E.R.C. ¶ 61,354, 105 F.E.R.C. ¶ 61,182, 103 F.E.R.C. ¶ 61,353, and 105 F.E.R.C. ¶ 61,185.

## JURISDICTION

The judgments of the court of appeals were entered on December 19, 2006. On March 6 and March 8, 2007, Justice Kennedy extended the time within which to file petitions for a writ of certiorari to and including May 3, 2007, and the petitions were filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. The Federal Power Act (FPA), 16 U.S.C. 791a *et seq.*, grants the Federal Energy Regulatory Commission (Commission or FERC) exclusive jurisdiction over the "transmission of electric energy in interstate commerce" and the "sale of electric energy at wholesale in interstate commerce." 16 U.S.C. 824(b)(1). Proposed rates for the sale or transmission of power within FERC's jurisdiction are subject to FERC review to ensure that they are "just and reasonable" and not unduly discriminatory or preferential. 16 U.S.C. 824d(a) and (b). To that end, the FPA provides that, "[u]nder such

[1] Unless otherwise noted, all references to "Pet." and "Pet. App." are to the petition and appendix in No. 06-1454.

rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, * * * schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission." 16 U.S.C. 824d(c).

2. Until the 1980s, the Commission established rates primarily on a cost-of-service basis. As barriers to entry in the generation sector declined, however, a competitive market for wholesale sales of electric energy began to emerge. In response to that development, the Commission began considering and approving market-based rates for wholesale electric energy sales in the late 1980s.

Under the Commission's market-based rate program, the Commission approves a seller's request to sell electric energy at market-based rates only if it first finds that the seller and its affiliates either do not have market power or have adequately mitigated their market power. See *California ex rel. Lockyer* v. *FERC*, 383 F.3d 1006, 1009 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007) (*Lockyer*). Specifically, the Commission undertakes an intensive factual review of the relevant product and geographic markets to determine whether, based on an analysis of market concentration during various seasons and load levels, the seller has market power. See *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity & Ancillary Servs. by Pub. Utils.*, 115 F.E.R.C. ¶ 61,210 (2006); *AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018, on reh'g, 108 F.E.R.C. ¶ 61,026 (2004). Market power is defined as a seller's ability to "'significantly influence price in the market by withholding service and excluding competitors for a sig-

nificant period of time.'" *Lockyer*, 383 F.3d at 1012 n.4 (quoting *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210, at 61,777 (1989)).

The Commission's review is designed to assure a competitive market, because "when there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result." *Elizabethtown Gas Co.* v. *FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993); see *Lockyer*, 383 F.3d at 1013 (noting that "[i]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable") (quoting *Tejas Power Corp.* v. *FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990)).

To assure that the Commission can monitor, on a continuing basis, the justness and reasonableness of market-based rates and the potential exercise of market power, the Commission also imposes an ongoing quarterly reporting requirement for market transactions. See *Lockyer*, 383 F.3d at 1013. The quarterly reporting requirement provides a means for the Commission and the public to identify pricing trends or discriminatory patterns that might suggest the exercise of market power. See *California ex rel. Lockyer*, 99 F.E.R.C. ¶ 61,247, at 62,063, reh'g denied, 100 F.E.R.C. ¶ 61,295 (2002). For each contract, sellers are required to report the buyer's and seller's name, a description of the service, the delivery point for the service, the price, "the quantities to be served or purchased; the contract's duration . . . and any other attributes of the product being purchased or sold which contribute to its market value."

*Lockyer*, 99 F.E.R.C. at 62,066 (quoting *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210, at 61,778 (1989)).

"After-the-fact reporting allows the market to operate initially without regulatory intrusion," avoiding the costs and practical difficulties that would be associated with prior review of a large number of transactions, many of which are of short duration. *Lockyer*, 99 F.E.R.C. at 62,065. At the same time, the reporting requirement provides the Commission with information with which it can monitor and oversee the rates being charged, and it places sellers on notice that their authorization to sell at market-based rates will be subject to continuing review and, if necessary, to remedial action, including the possible revocation of that authorization. *Ibid.* Further, upon finding a tariff violation, the Commission may take retroactive action, including ordering the disgorgement of unjust profits. *California ex rel. Lockyer* v. *British Columbia Power Exch.*, 100 F.E.R.C. ¶ 61,295, at 62,334 (2002).

3. In 1995, in response to retail electric rates that were well above the national average, California comprehensively restructured the electric energy industry in that State. At that time, the major traditional investor-owned utilities were vertically integrated; that is, they owned generating resources, transmission lines, and distribution facilities. *Lockyer*, 383 F.3d at 1008-1009 & n.2. Under the restructuring, those utilities were required to divest most of their generating assets and to purchase power at market-based rates through an independent power exchange, which operated an organized wholesale market, and an independent system operator, which managed the transmission network.

As part of California's restructuring plan, California's three major investor-owned utilities filed applications with FERC seeking authority to sell electric energy at wholesale at market-based rates. In accordance with its established policy, FERC approved their requests for market-based rate authority after finding that the companies and their affiliates either did not have, or had adequately mitigated, market power. See, *e.g.*, *Pacific Gas & Elec. Co.*, 81 F.E.R.C. ¶ 61,122, at 61,437, 61,537, 61,572 (1997), aff'd, 82 F.E.R.C. ¶ 61,223 (1998). FERC also reviewed and approved applications by other wholesale generators and suppliers that lacked, or had adequately mitigated, market power to sell electric energy at market-based rates in the California markets. See, *e.g.*, *Lockyer*, 99 F.E.R.C. at 62,055.

For two years, the restructured California electricity markets operated largely as intended. Starting in the summer of 2000, however, wholesale electricity prices in California increased significantly, with the day-ahead market peaking at a 15-fold increase over the pre-restructuring average cost. See *In re Cal. Power Exch. Corp.*, 245 F.3d 1110, 1115 n.2 (9th Cir. 2001). As a result, load-serving utilities incurred billions of dollars of debt, and the independent system operator declared dozens of system emergencies and occasional rolling blackouts. *Id.* at 1115-1116.

Acting in response to a complaint filed on August 2, 2000, FERC took steps to remedy the situation. Specifically, it implemented structural and pricing reforms to make California and western electricity markets more stable and less susceptible to price spikes. See, *e.g.*, *California Power Exch.*, 245 F.3d at 1114-1116; *San Diego Gas & Elec. Co.* v. *Sellers of Energy & Ancillary Servs.*,

93 F.E.R.C. ¶ 61,294, at 61,982 (2000). The Commission also urged the California utilities to enter into long-term contracts, finding that a key structural flaw of the California market was the State's decision to place primary reliance on spot-market purchases. As a result of these steps and other factors, by early June 2001, prices in California spot and forward markets fell back to preexisting competitive levels. See *San Diego Gas & Elec. Co.* v. *Sellers of Energy & Ancillary Servs.*, 95 F.E.R.C. ¶ 61,418, at 62,546 (2001).

4. The western energy crisis generated considerable litigation. In an earlier proceeding, the Court of Appeals for the Ninth Circuit reviewed a broad challenge to the Commission's market-based rate program, in which some parties argued that any market-based rate contract must actually be filed with the Commission for it to be effective. See *Lockyer*, 383 F.3d at 1011-1013. The court of appeals rejected that challenge, holding that "the dual requirement of an ex ante finding of the absence of market power *and* sufficient post-approval reporting requirements" are sufficient to satisfy the notice and filing requirements of the FPA. *Id.* at 1013. But the court found that "non-compliance with FERC's reporting requirements was rampant" during the western energy crisis, and it therefore remanded the case to the Commission to consider whether such noncompliance was sufficient to merit refunds to the purchasers under those contracts. See *id.* at 1014. This Court denied certiorari. See *Coral Power, L.L.C.* v. *California ex rel. Brown*, 127 S. Ct. 2972 (2007) (No. 06-888).

5. The proceedings below concerned challenges to specific long-term contracts entered into during the 2000-2001 western energy crisis. The purchasers filed

complaints with FERC, arguing that the contracts should be reformed because they were tainted by market power or dysfunction. The Commission denied the complaints. Pet. App. 91a-214a; 06-1462 Pet. App. 246a-313a.

The Commission's orders cited this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*). Pet. App. 93a; 06-1462 Pet. App. 90a-91a. In *Mobile*, the Court interpreted provisions of the Natural Gas Act that parallel the FPA, and it held that the statute "preserv[es] the integrity of contracts" and does not permit companies unilaterally to change those contracts. 350 U.S. at 344. The same day, the Court held in *Sierra* that the Federal Power Commission could not declare a rate set by contract to be "unreasonable solely because it yields less than a fair return on the net invested capital." *Id.* at 355. Rather, "the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest." *Ibid.* The *Mobile-Sierra* doctrine, grounded in those two decisions, rests on the assumption that "[i]n wholesale markets, the party charging the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Commc'ns Inc.* v. *FCC*, 535 U.S. 467, 479 (2002).

Applying *Mobile-Sierra*, the Commission concluded that the appropriate standard of review for the contracts at issue in this case was the "public interest" standard rather than the ordinary "just and reasonable" stan-

dard. Pet. App. 93a; 06-1462 Pet. App. 248a-249a. Since the purchasers had not shown that the contracts were contrary to the public interest, the Commission denied the complaints. Pet. App. 95a-96a; 06-1462 Pet. App. 248a.

6. The purchasers petitioned for review. In a pair of decisions issued the same day, the court of appeals granted the petitions and remanded the cases to FERC for further proceedings. Pet. App. 1a-15a, 268a-329a.

The court of appeals stated that "there is but one statutory standard addressing the lawfulness of wholesale electricity rates," and "[t]hat standard requires that *all* rates be 'just and reasonable.'" Pet. App. 300a. The *Mobile-Sierra* doctrine, the court reasoned, is simply "one means of review under the just and reasonable standard, applicable in certain limited circumstances." *Ibid.* Specifically, the court concluded that *Mobile-Sierra* applies when three conditions are met: (1) the terms of the contract must not preclude its application, *id.* at 301a; (2) "the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for initial review of the contracted rate," *id.* at 303a; and (3) "the scope of that review must permit consideration of the factors relevant to the propriety of the contract's formation," *id.* at 305a. See *id.* at 9a.

The court of appeals concluded that FERC erred in its application of the *Mobile-Sierra* doctrine to the contracts at issue in these cases. The court agreed with the Commission that the contracts did not preclude the application of *Mobile-Sierra*. Pet. App. 306a-309a. But it held that FERC did not have an opportunity for timely and effective review of rates. While acknowledging that "market-based rate authority *can* qualify as sufficient

prior review to justify limited *Mobile-Sierra* review," the court stated that market-based rates must be "accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change." *Id.* at 309a-310a. As in *Lockyer*, the court believed that the Commission failed appropriately to oversee market-based rates during the western energy crisis. *Id.* at 319a. In the court's view, quarterly reporting was "unlikely to expose in a timely manner the impact of market changes," and it allowed "review of the grounds for market-based rate authority only with regard to contracts entered into *after* the impact of the market dysfunction or market power on long-term bilateral contracts has already occurred." *Id.* at 315a.

Added to that "procedural error" was the Commission's "substantive adherence to *Mobile-Sierra* without regard to the market conditions in which the contracts at issue were formed." Pet. App. 320a. "*Mobile-Sierra* cannot apply," the court of appeals reasoned, "without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." *Ibid.* The court found that FERC had failed to consider evidence that "the dysfunction and manipulation of the spot market[] artificially influenced the rates in the forward market," *id.* at 321a, notwithstanding the conclusion of a FERC staff report that "forward power prices negotiated during 2000-2001 in the western United States were *significantly influenced* by the then-current spot power prices," *id.* at 320a (quoting FERC Staff, *Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation*

*of Electric and Natural Gas Prices* ES-12 (2003) (*Staff Report*)) <www.ferc.gov/legal/maj-ord-reg/land-docs/PART-I-3-26-03.pdf>.

The court went on to state that, even if the *Mobile-Sierra* doctrine applied, the Commission had used "an erroneous standard for determining whether the challenged contracts affect the public interest." Pet. App. 322a-323a. Specifically, the court concluded that FERC had erroneously applied "factors taken from the context of a *low-rate* challenge rather than those relevant to the *high-rate* challenge present in this case." *Id.* at 323a. FERC should instead have considered whether the contracts were "outside the 'zone of reasonableness' and result[ed] in retail rates higher than would be the case if that zone were not exceeded." *Id.* at 327a.

The court remanded to the Commission "to determine, first, whether *Mobile-Sierra* review of the challenged contracts is appropriate; second, if so, to apply the modified form of *Mobile-Sierra* review outlined in this opinion; and finally, if not, to apply full just and reasonable review to the challenged contracts." Pet. App. 328a; see *id.* at 15a.

## ARGUMENT

Petitioners argue (06-1457 Pet. 15) that the decisions of the court of appeals are contrary to settled precedent, placing *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), "in the historical dustbin." Petitioners greatly overstate the breadth of the opinions below. The opinions do not overturn long-term power contracts. Instead, they remand to the Commission for further factual inquiry. The opinions do not hold that *Mobile-Sierra* protections are unavailable to

market-based rate contracts unless they are first reviewed by the Commission. Instead, they hold that market-based rate authority qualifies as sufficient prior rate review to justify *Mobile-Sierra* contract review, so long as it is accompanied by continuing and effective oversight of the market. And the opinions do not overturn the *Mobile-Sierra* doctrine. Instead, they apply the principles of *Mobile* and *Sierra* to the highly unusual context of the 2000-2001 western energy crisis, the worst electricity-market crisis in American history. The decisions below stand for the narrow proposition that, if there is a credible claim that severe market dysfunction has affected the formation of a market-based contract, the Commission must take that fact into account in determining whether the public-interest standard of *Mobile-Sierra* applies to its review of that contract.

Taken as a whole, the decisions of the court of appeals allow the Commission sufficient discretion on remand to consider all relevant factors in determining whether the contracts at issue should be upheld or reformed. Allowing the Commission to address these issues on remand will not "cause severe damage to the wholesale energy markets." 06-1457 Pet. 25. The decisions have not, as petitioners suggest, caused a flood of complaints by disgruntled purchasers seeking to reform contracts. In fact, there have been relatively few complaints, and, more important, the Commission has promptly rejected those that lack merit. See, *e.g.*, *Californians for Renewable Energy, Inc.* v. *California Pub. Utils. Comm'n*, 119 F.E.R.C. ¶ 61,058 (2007) (*CARE*).

Petitioners allege various conflicts between the decisions below and the decisions of this Court and other courts of appeals, but their arguments ignore the unique

nature of the western energy crisis of 2000-2001. None of the cases on which they rely addressed a remotely similar event. As FERC applies the decisions below to future contracts—not affected by the unprecedented market dysfunction of the 2000-2001 crisis—there is no reason to suppose that it will reach conclusions different from those that it would reach if it were to apply the decisions of other courts of appeals. Further review is not warranted.

1. Petitioners contend (Pet. 15-17, 20; 06-1457 Pet. 17; 06-1462 Pet. 11-13; 06-1468 Pet. 14-17) that the court of appeals limited the application of the *Mobile-Sierra* doctrine to instances in which FERC reviews the terms of a contract before it takes effect. In their view, the decision below has effectively eliminated *Mobile-Sierra* protections in the context of market-based rates, making market-based rate approval a useless exercise. Petitioners misinterpret the court's opinions.

As petitioners point out, the court of appeals stated that "the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for initial review of the contracted rate." Pet. App. 303a. But the court also took pains to emphasize, as it had two years earlier in *Lockyer*, that in "the contemporary regulatory regime," the requisite initial review "can be limited to review of a utility's market-based rate authority in the first instance." *Id.* at 302a; see *id.* at 309a-310a (noting that "market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review," so long as it is "accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change"); *id.* at 311a-312a; see also *Lockyer*, 383 F.3d at 1013. Thus, the

court did not hold that the filing of a contract with the Commission is a necessary prerequisite to the application of *Mobile-Sierra*.[2] Instead, the court of appeals remanded for two narrower reasons, neither of which merits further review.

a. First, the court held that the Commission did not adequately oversee the market after granting petitioners' market-based rate authority during the western energy crisis. Pet. App. 314a-320a. That finding is primarily of historical interest, given that the oversight regime that exists today is far different from that which existed in 2000-2001.

Since the western energy crisis, and in no small part because of it, the Commission has created a new Office of Enforcement to oversee markets and enforce compliance with its orders and regulations; it has increased the transparency of market information to enhance its oversight function; it has reformed California electricity markets to correct the design flaws that contributed to the crisis; and it has adopted a more rigorous market power analysis in reviewing market-based rate requests

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[2] Petitioners cite numerous cases in which other circuits have held that *Mobile-Sierra* applies to contracts not filed with the Commission. See 06-1462 Pet. 11-13; 06-1468 Pet. 16-17; Pet. 16-17. Because the court of appeals in this case did not hold that such filing is required for to the application of *Mobile-Sierra*, there is no conflict.

Petitioner Dynegy notes (06-1468 Pet. 17-18) that it *did* file its contract with the Commission. The court of appeals did not consider that fact to be dispositive, because, "[a]t the time Dynegy filed its contract, the full scale of market manipulation and forward market dysfunction was not nearly as fully known as it is today." Pet. App. 11a. In other words, the result in Dynegy's case rested on the court's holding that market dysfunction is relevant to determining whether to apply the *Mobile-Sierra* public-interest test. For the reasons discussed at pp. 16-18, *infra*, that holding does not warrant review.

and has imposed additional requirements, including change-in-status filing requirements, as a condition of retaining market-based rate authority.[3] In addition, Congress has enacted legislation giving the Commission

[3] See generally *CARE*, 119 F.E.R.C. ¶ 61,058 paras. 31-41 (describing steps taken by the Commission "to ensure that there are appropriate market safeguards in place to prevent a repeat of the California 2000-2001 energy crisis"); see also, *e.g.*, *Revised Pub. Util. Filing Requirements*, 99 F.E.R.C. ¶ 61,107 (2002) (Order No. 2001) (requiring electronic filing of quarterly reports providing transaction-specific data on wholesale power sales) (67 Fed. Reg. 31,044 (2002)), order on reh'g, 100 F.E.R.C. ¶ 61,074 (2002), order on reh'g, 100 F.E.R.C. ¶ 61,342 (2002); *Order Amending Market-Based Rate Tariffs & Authorizations*, 105 F.E.R.C. ¶ 61,218 (2003) (imposing market behavioral rules in all market-based rate tariffs), order on reh'g, 107 F.E.R.C. ¶ 61,175 (2004), petition for review denied, No. 04-1238, 2007 WL 1791011 (D.C. Cir. June 22, 2007); *Electric Quarterly Reports*, 105 F.E.R.C. ¶ 61,219 (2003) (revoking market-based rate authority for utilities that failed to meet reporting requirements); *Order Revoking Market-Based Rate Auth., Establishing Hearing & Settlement Judge Procedures, & Terminating Sec. 206 Proceeding*, 113 F.E.R.C. ¶ 61,124 (2005) (same); *AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018 (2004) (adopting new interim generation market-power analysis and mitigation policy), on reh'g, 108 F.E.R.C. ¶ 61,026 (2004); *Reporting Requirement for Changes in Status for Pub. Utils. with Market-Based Rate Auth.*, 110 F.E.R.C. ¶ 61,097 (Order No. 652) (amending regulations to establish a reporting obligation for changes in status that apply to public utilities authorized to make sales at market-based rates) (70 Fed. Reg. 8253 (2005)), reh'g granted in part, 111 F.E.R.C. ¶ 61,413 (2005); *Prohibition of Energy Mkt. Manipulation*, 114 F.E.R.C. ¶ 61,047 (2006) (Order No. 670) (amending Commission regulations to implement new Section 222 of the Federal Power Act, prohibiting the employment of manipulative or deceptive devices or contrivances) (71 Fed. Reg. 4244 (2006)). See also *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity, & Ancillary Servs. by Pub. Utils.*, 119 F.E.R.C. ¶ 61,295 (2007) (revising current standards for market-based rate sales); *Notice of Proposed Rulemaking*, 118 F.E.R.C. ¶ 61,031 (2007) (proposing revised standards of conduct for electric transmission providers) (72 Fed. Reg. 3958 (2007)).

authority to punish market manipulation and impose civil penalties for market rule violations. See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1283, 119 Stat. 979 (to be codified at 16 U.S.C. 824v (Supp. V 2005)) (authorizing FERC to prohibit "any manipulative or deceptive device or contrivance" by "any entity" in connection with a FERC-jurisdictional transaction); § 1284, 119 Stat. 980 (to be codified at 16 U.S.C. 825o-1 (Supp. V 2005)) (providing for enhanced civil penalties for willful violations of Part II of the FPA).

The Commission has already recognized the relevance of these new measures to the evaluation of contracts under *Mobile-Sierra*. In an opinion issued subsequent to the Ninth Circuit's decision in this case, FERC explained that the decision below "addressed a unique set of facts and a market-based rate program that has undergone substantial improvements since 2001." *CARE*, 119 F.E.R.C. ¶ 61,058 para. 29. In light of those improvements in FERC's market oversight, when sellers "have been granted market-based rate authority, the wholesale contracts that they have entered into are presumed to be just and reasonable." *Id.* para. 42.

b. As an independent basis for its remand, the court of appeals held that the Commission erred in determining, as a matter of law, that market dysfunction is irrelevant to whether the public-interest standard applies. Pet. App. 320a. As the court noted, the Commission's staff had found that "forward power prices negotiated during 2000-2001 in the western United States were significantly influenced by then-current spot power prices," and "that the trauma of the dysfunctional spot power prices at that time so influenced buyers that they placed great weight on these prices in forming future expecta-

tions." *Staff Report* ES-9; Pet. App. 320a. But the Commission declined to consider that evidence in determining whether or not the public-interest standard governed its review of the contracts, choosing instead to consider it as one factor in deciding whether, applying the public-interest standard, the contracts should be modified. 06-1462 Pet. App. 292a-293a; Pet. App. 108a-109a. As the Commission saw it, to justify contract modification under the public-interest standard, it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot-market dysfunction; rather, it must be shown that the contract rates, terms, and conditions were contrary to the public interest. *Ibid.* The court of appeals found the Commission's approach erroneous, however, because the Commission failed "ever to consider whether the influence of the spot markets on the forward markets reached a level sufficient to question whether FERC could assume that two private parties had negotiated a 'just and reasonable' contract in the first instance and therefore apply the *Mobile-Sierra* presumption." Pet. App. 321a.

The court's conclusion does not warrant review at this time because it is unclear how its position differs, in practical effect, from that of the Commission. Although the court criticized the Commission's approach, it did not explain its alternative approach in any detail. It appears that the court contemplates a two-step analysis in which the Commission first considers whether market dysfunction was so severe as to undermine *Mobile-Sierra*'s presumption that contract prices reflect a fair bargain between a willing buyer and a willing seller. See Pet. App. 320a (application of *Mobile-Sierra* requires "a determination that the challenged contract

was initially formed free from the influence of improper factors, such as market manipulation"). Once that test is applied, the court seems to contemplate an analysis of whether to uphold or reform the contract based on all relevant factors under either the public-interest standard, if applicable, or the just-and-reasonable standard. *Id.* at 322a-327a.

Because the court of appeals has not specified the required inquiry in any detail, it has not restricted the Commission's ability, on remand, to consider all relevant facts in its analysis. Petitioners argue (06-1457 Pet. 23) that spot-market dysfunction is irrelevant as a matter of law because it is just another "fact about the world" that purchasers consider when entering into forward contracts. While spot-market dysfunction may be a "fact about the world," it is a very important fact. Recognizing this, the Commission's orders below did not disregard the spot-market dysfunction; rather, the Commission considered it as part of the "totality of circumstances" in considering whether the contracts offended the public interest. 06-1462 Pet. App. 339a; Pet. App. 111a. Even though the Commission upheld the contracts, it never suggested that the spot-market dysfunction was irrelevant as a matter of law in determining whether the public-interest standard could be overcome. The court has simply directed the Commission to consider spot-market dysfunction at a different stage in its analysis, and it is far from clear that the difference will be outcome-determinative in this or any other case. Nor is it likely that market dysfunction of the kind that occurred in the 2000-2001 western energy crisis will occur in the future. See pp. 6, 12-13, *supra*.

Petitioners also suggest (06-1468 Pet. 19-20) that the decision below conflicts with *Northeast Utils. Serv. Co.* v. *FERC*, 993 F.2d 937, 961 (1993), in which the First Circuit held that market power is not relevant to the application of *Mobile-Sierra*. Although the First Circuit did express that view initially, on a subsequent appeal following its remand, the First Circuit noted that, while it previously "questioned the significance of the seller's market power and the lack of arms-length bargaining, it left open the possibility that these factors may so affect third parties as to warrant intervention even under the public interest standard." *Northeast Util. Serv. Co.* v. *FERC*, 55 F.3d 686, 691-692 (1st Cir. 1995) (*Northeast Utils.*) (citation omitted). On its second review of the case, the First Circuit affirmed the Commission's application of a "more flexible" public-interest review of the contract at issue because the Commission had explained why the disputed contractual terms might harm third parties. *Id.* at 692. That holding is consistent with the approach taken by the court of appeals in this case.

2. Petitioners also contend that the court of appeals improperly "collapses" the public-interest and the just-and-reasonable standards in a "high rate" case, that is, a case in which a purchaser challenges a rate as excessively high. Pet. 24-25; 06-1468 Pet. 25-26. Here, too, petitioners misread the court's opinions.

Petitioners focus on the court of appeals' statement that "the proper standard * * * is not whether the contracted rates pose an 'excessive burden' on consumers, but whether the wholesale energy contract is outside the 'zone of reasonableness' and results in retail rates higher than would be the case if that zone were not exceeded." Pet. App. 326a-327a. But the court of ap-

peals expressly rejected the proposition "that *any* direct impact on consumer rates is enough to demonstrate a public interest effect sufficient to displace the countervailing *Mobile Sierra* concern with protecting the stability of contract." *Id.* at 326a. Instead, while noting that "a functioning marketplace will drive prices towards marginal cost, and therefore towards * * * a reasonable range," the court made clear that, "[e]ven if a particular rate exceeds marginal cost * * * it may still be within this reasonable range—or 'zone of reasonableness'—if that higher-than-cost-based price results from normal market forces and is part of a general trend toward rates that do reflect costs." *Ibid.* Thus, contracts entered into in a "functioning marketplace" do not offend the public interest simply because the rates are above traditional measures of cost. *Ibid.*

Petitioners argue (Pet. 26) that the court of appeals created a "heads I win, tails you lose" rule in which purchasers can "challenge any contracts that are no longer favorable to them," but sellers cannot. As explained above, the court's application of the public-interest test does not permit a party to challenge a contract simply because it is "no longer favorable." Indeed, even under the just-and-reasonable standard, a purchaser may not claim "buyer's remorse" and be excused from a long-term contract simply because market prices have fallen during the term of the contract. Rather, it must demonstrate that the relative benefits and burdens have been upset over the life of the contract. See, *e.g.*, *Pontook Operating Ltd. P'ship* v. *Public Serv. Comm'n*, 94 F.E.R.C. ¶ 61,144, at 61,552 (2001); *French Broad Elec. Membership Corp.* v. *Carolina Power & Light Co.*, 92

F.E.R.C. ¶ 61,283 (2000); *San Diego Gas & Elec. Co.* v. *Public Serv. Comm'n*, 95 F.E.R.C. ¶ 61,073 (2001).

Nor did the court create a rule that is biased against sellers. In many of the portions of its opinion cited by petitioners, the court was simply observing that the factual considerations in low-rate and high-rate cases differ, a point that is neither surprising nor new. For example, the potential insolvency of a seller is always a concern in a low-rate case. See, *e.g.*, *Sierra*, 350 U.S. at 355 (noting that a low rate "might impair the financial ability of the public utility to continue its service"). In contrast, in a high-rate case, a purchaser may be able to pass rates on to its customers without going bankrupt. As the First Circuit has held, the *Sierra* "definition of what is necessary in the public interest was formulated in the context of a *low-rate* case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." *Northeast Utils.*, 55 F.3d at 690.

Contrary to petitioners' suggestion, the court of appeals also recognized the importance of contractual stability, even in high-rate cases. For example, in addition to acknowledging that a functioning marketplace can often produce high rates—and that such rates can be consistent with the public interest—the court made clear that "the stability of contract considerations that underlie the *Mobile-Sierra* doctrine do carry over to challenges by buyers rather than sellers." Pet. App. 325a.

In any event, this case is a poor vehicle for considering the application of the public-interest standard to a high-rate case. The court's interpretation of the public-interest standard was unnecessary to its decision, since

it had already remanded the case because of the Commission's failure to consider adequately whether the public-interest standard applies at all. And on remand, the Commission will be able to consider the issue in a manner consistent with traditional *Mobile-Sierra* principles, obviating many of the concerns raised by petitioners. In fact, FERC has already demonstrated that, in applying the principles of the court's decisions, it will protect contractual stability. The Commission has explained that it "protects customers * * * by providing rate stability through the protection of sales contracts," and that its "improved market-based rate program provides the foundation to ensure that sellers and buyers can continue to rely on market-based rate contracts to provide price certainty." *CARE*, 119 F.E.R.C. ¶ 61,058 para. 40. At this point, then, any consideration by this Court would be premature because the Court's review would benefit from the better-developed record that would be produced by FERC's application in the first instance on remand of the principles set out by the court of appeals.

3. Petitioners allege numerous conflicts between the decisions below and various decisions of other courts of appeals (Pet. 26; 06-1457 Pet. 24; 06-1462 Pet. 13-14; 06-1468 Pet. 15-16), but they ignore the obvious point that no other case addressed facts even remotely similar to those at issue here. The western energy crisis was the worst in the Nation's history. It arose from an unprecedented confluence of "flawed market rules; inadequate addition of generating facilities in the preceding years; a drop in available hydropower due to drought conditions; a rupture of a major pipeline supplying natural gas into California; strong growth in the economy and in electricity demand; unusually high temperatures; an

increase in unplanned outages of extremely old generating facilities; and market manipulation." *CARE*, 119 F.E.R.C. ¶ 61,058 para. 30. Those factors combined "to place California and the entire West in an electricity crisis that had never before been experienced." *Ibid.* The resulting crisis was hardly comparable, as petitioners suggest (06-1457 Pet. 22), to "the change in prices * * * caused by the sudden availability of power from the Shasta dam" in *Sierra*.

In two of the decisions on which petitioners rely, the courts of appeals actually affirmed Commission decisions to *reform* a contract under *Mobile-Sierra*. In *Northeast Utilities*, the First Circuit considered a power contract that was potentially harmful to third parties. Despite the presence of a *Mobile-Sierra* clause, the Commission reformed the contract to remedy the potential harm, and the court upheld the Commission's decision. See 55 F.3d at 692. Likewise, in *Maine Public Utilities Commission* v. *FERC*, 454 F.3d 278 (2006), the D.C. Circuit addressed a proposal by New England's transmission owners to pull out of a regional market without adequate prior review by the Commission. Despite the presence of a *Mobile-Sierra* clause, the Commission reformed the contract to require a meaningful prior review by the Commission before the transmission owners could withdraw from the market, and the D.C. Circuit upheld the Commission's action. See *id.* at 284.

Other cases rejected challenges to contracts, but none of them involved facts similar to those here. In *Potomac Electric Power Co.* v. *FERC*, 210 F.3d 403 (2000), the D.C. Circuit addressed a claim by a purchaser that its transmission rate in its 1987 contracts had become unreasonable over time. The Commission

rejected the complaint, and the court upheld the decision because the purchaser "presented no evidence" that the rates were "unduly discriminatory or excessively burdensome on [the purchaser's] ratepayers." *Id.* at 409. In *Boston Edison Co.* v. *FERC*, 233 F.3d 60 (2000), the First Circuit vacated and remanded Commission orders applying a just-and-reasonable standard to reduce a seller's return on equity. In remanding the case for application of the public-interest standard, the court noted that "[v]ery little useful precedent exists" addressing the question whether rates are "so high as to be contrary to the public interest." *Id.* at 68. And in *San Diego Gas & Electric Co.* v. *FERC*, 904 F.2d 727, 730 (1990), the D.C. Circuit affirmed Commission orders rejecting a buyer's argument that a contract should be modified based on after-the-fact market changes.

None of the cited cases concerned a market-based rate contract, much less one entered into during the Nation's worst power crisis. At most, they illustrate the Commission's longstanding commitment to contractual stability, a commitment that has not lessened in the wake of the decisions at issue here. See *CARE*, 119 F.E.R.C. ¶ 61,058 para. 40.

4. Petitioners present a number of arguments based upon the particular factual circumstances of their individual cases. For example, some of the contracts included recitations to the effect that the terms were "'just' and 'reasonable' within the meaning of the FPA" (Pet. 22-23); some involved purchasers who were power marketers, not merely retail providers (06-1462 Pet. 17-19); and some were agreed to by parties who were already aware of market dysfunction (06-1468 Pet. 22-23).

In one case, the seller alleged that the contract would result in a relatively modest increase in retail rates. 06-1457 Pet. 23-24. In another, the purchasers presented evidence to the court of appeals that they had failed to present to FERC. Pet. 29-30.

Petitioners may present those (and other) case-specific arguments on remand, and the Commission may take them into account in addressing whether each contract should be reformed. If petitioners are dissatisfied with the result on remand, they will be able to seek agency rehearing and judicial review. See 16 U.S.C. 825*l*(a)-(b). At present, the interlocutory nature of those issues makes this Court's review premature. See *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916).

## CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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